

REPORT OF EXAMINATION
OF THE
REPUBLIC INDEMNITY COMPANY OF CALIFORNIA
AS OF
DECEMBER 31, 2004

Participating State
and Zone:

California

Filed June 19, 2006

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Los Angeles, California
April 5, 2006

Honorable Alfred W. Gross
Chairman of the NAIC Financial
Condition Subcommittee
Commissioner of Insurance
Virginia Bureau of Insurance
Richmond, Virginia

Honorable Gary L. Smith
Secretary, Zone IV-Western
Director of Insurance
Department of Insurance, State of Idaho
Boise, Idaho

Honorable John Garamendi
Insurance Commissioner
California Department of Insurance
Sacramento, California

Dear Chairman, Director and Commissioner:

Pursuant to your instructions, an examination was made of the

REPUBLIC INDEMNITY COMPANY OF CALIFORNIA

(hereinafter also referred to as the Company) at its home office located at 15821 Ventura Boulevard, Encino, California 91436.

SCOPE OF EXAMINATION

The previous examination of the Company was made as of December 31, 2001. This examination covers the period from January 1, 2002 through December 31, 2004. This examination was conducted pursuant to the National Association of Insurance Commissioners' plan of examination. The examination included a review of the Company's practices and procedures, an examination of management records, tests and analyses of detailed transactions within the examination period, and an evaluation of the assets and a determination of liabilities as of December 31, 2004, as deemed necessary under the circumstances.

The examination was conducted concurrently with the examination of the Company's parent, Republic Indemnity Company of America.

In addition to those items specifically commented upon in this report, other phases of the Company's operations were reviewed including the following areas that require no further comment: corporate records, fidelity bonds and other insurance; officers', employees' and agents' welfare and pension plans; growth of company; business in force by states; loss experience; accounts and records; and sales and advertising.

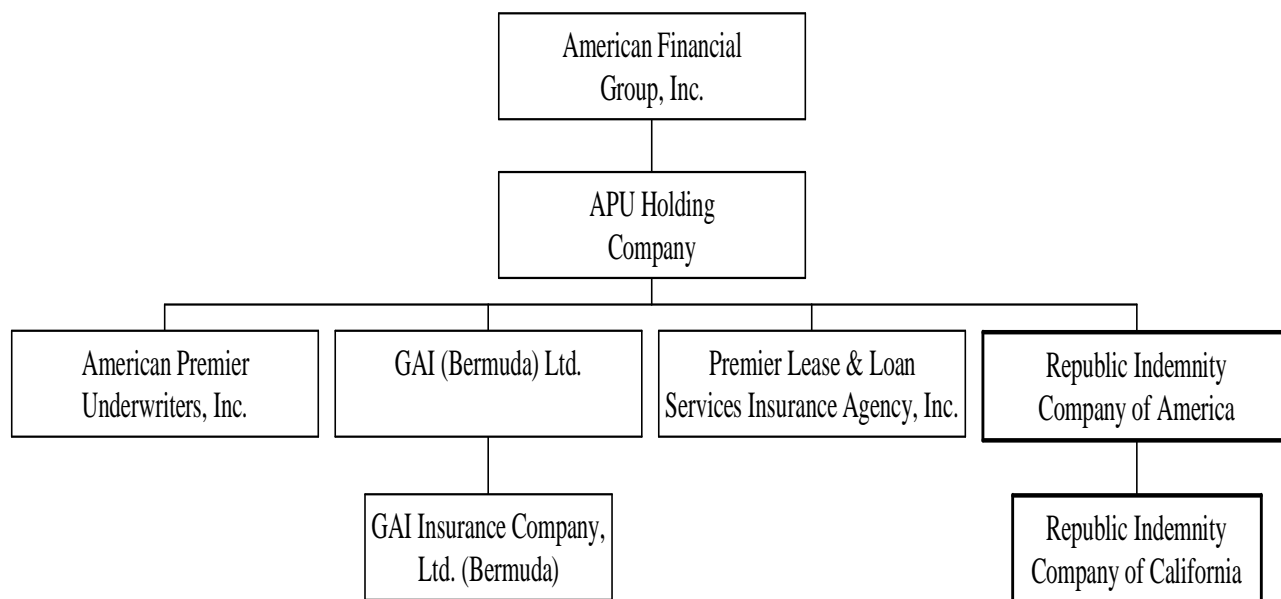
COMPANY HISTORY

The Company was incorporated under the laws of California on October 13, 1982 and commenced business on January 20, 1983. The Company is a wholly-owned subsidiary of Republic Indemnity Company of America (RICA) who, in turn, is wholly-owned by APU Holding Company. The Company's ultimate parent is American Financial Group, Inc. (AFG).

On February 28, 2003, RICA made a \$3.2 million cash capital contribution to the Company. As a result, the balance of the gross paid-in and contributed surplus account increased from \$3,195,000 to \$6,395,000.

MANAGEMENT AND CONTROL

The following abridged organizational chart depicts the Company's relationship within the holding company system at December 31, 2004:



Management of the Company is vested in a seven-member board of directors elected annually. A listing of the members of the board and principal officers serving on December 31, 2004 follows:

Directors

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Gary J. Gruber Cincinnati, Ohio	Senior Vice President Great American Insurance Company
Dwayne T. Marioni Novato, California	President and Chief Executive Officer Republic Indemnity Company of America
Keith A. Jensen Cincinnati, Ohio	Executive Vice President Great American Insurance Company
Karen Holley Horrell Cincinnati, Ohio	Senior Vice President Great American Insurance Company
David P. Mitchell Agoura Hills, California	Senior Vice President Republic Indemnity Company of America
David Harkins Westlake Village, California	Senior Vice President Republic Indemnity Company of America
Dion G. Riley Chatsworth, California	Senior Vice President Republic Indemnity Company of America

Principal Officers

<u>Name</u>	<u>Title</u>
Gary J. Gruber	Chairman
Dwayne T. Marioni	President and Chief Executive Officer
Dion G. Riley	Senior Vice President, Chief Financial Officer and Treasurer
Michael J. Kirrene	Senior Vice President and Chief Information Officer
Frank M. Ceraolo	Senior Vice President
David Harkins	Senior Vice President
David P. Mitchell	Senior Vice President

Affiliated Management Agreements

Workers' Compensation Handling Agreement and Workflow Process: On March 1, 2003 the Company entered into a Workers' Compensation Handling Agreement and Workflow Process (Agreement) with Alternative Markets, a division of Great American Insurance Company (GAIC). Under this Agreement, Alternative Markets adjusts workers' compensation claims arising out of the policies issued by GAIC on behalf of the Company. These policies are reinsured 100% by the Company. Claim adjusting fees are based on a flat rate of \$1,350 for indemnity claims, \$150 for medical only claims and \$1,200 for medical only claims that are converted to indemnity claims. During the years 2003 and 2004, the Company paid GAIC \$884 and \$489, respectively. Under California Insurance Code (CIC) Section 1215.5(b)(4), this Agreement requires prior approval from the California Department of Insurance (CA-DOI). It is recommended that the Company comply with CIC Section 1215.5(b)(4) by obtaining approval of this Agreement with the CA-DOI.

General Services Agreement: On August 1, 1996 the Company entered into a General Services Agreement by and between 49 affiliated insurance companies (collectively referred to as the Parties) of GAIC holding company group. Under the terms of this agreement, the Parties furnish various services, such as printing, office duplicating, telecommunications, purchasing, personnel, administrative and data processing to each other. Charges for these services are based on actual cost. During the years 2002, 2003, and 2004, the Company paid GAIC \$39,997, \$38,918 and \$63,206, respectively.

Investment Services Agreement: On January 1, 1996 the Company amended and restated its Investment Services Agreement with American Money Management Corporation (AMMC), an affiliated Company. Under the terms of the agreement, AMMC provides management and accounting services related to the Company's investment portfolio which include counsel and advice in connection with the formulation of investment programs and strategies. In addition, AMMC manages the investment of the Company's portfolio of invested assets in accordance with the Company's investment policy.

The Company pays AMMC an annual fee equaling 0.20% of the first \$500 million of invested assets plus 0.10% of the portfolio that exceeds \$500 million, but no more than the actual cost of these services. During the years 2002, 2003 and 2004, the Company paid AMMC \$34,301, \$31,818 and \$28,216, respectively.

Tax Allocation Agreement: The Company's federal income tax return is consolidated with that of American Financial Group, Inc. and its affiliates. This agreement was entered into on May 13, 1974. Pursuant to this written agreement, the amount of the Company's tax liability or refund is determined as if the Company was filing on a separate return basis. Estimated allocations are determined and payable quarterly and final allocations are made and paid annually. Effective December 31, 2005, the Company and its affiliates entered into a new tax allocation agreement in order to clarify and specify the allocation methods applicable to all tax returns. In addition, the new agreement clearly affirms all the entities participating in the agreement. The new agreement was approved by the CA-DOI on November 29, 2005.

TERRITORY AND PLAN OF OPERATION

As of December 31, 2004, the Company was licensed to write various property and casualty coverages in the District of Columbia and the following 37 states:

Alabama	Illinois	Montana	South Dakota
Alaska	Indiana	Nebraska	Tennessee
Arizona	Iowa	Nevada	Texas
Arkansas	Kansas	New Mexico	Utah
California	Kentucky	North Carolina	Washington
Colorado	Louisiana	Ohio	West Virginia
Delaware	Maryland	Oklahoma	Wisconsin
Georgia	Michigan	Oregon	
Hawaii	Mississippi	Rhode Island	
Idaho	Missouri	South Carolina	

During 2004, the Company wrote \$300 million of direct premiums that consisted principally of workers' compensation business. Of the direct premiums written, \$288 million (96%) was written in California and \$5.6 million (1.9%) was written in Nevada.

Workers' compensation business is written through approximately 1,011 independent agents who target all risk classes except petroleum and mining. The Company maintains branch offices in: Englewood, Colorado; Henderson, Nevada; Phoenix, Arizona; Portland, Oregon; Encino (also the home office), San Diego and San Francisco, California.

REINSURANCE

Inter-company Pooling Agreement

The Company and its parent, Republic Indemnity Company of America (RICA), are parties to an inter-company pooling agreement. Under the terms of the agreement, substantially all business written by the two companies is pooled. Premiums, losses and expenses incurred are then reapportioned and shared by RICA and the Company in the proportions of 97% and 3%, respectively.

Ceded

The following is a summary of the Company's principal reinsurance agreements in-force and in run-off as of December 31, 2004:

Type of Contract	Reinsurer's Name	Company's Retention	Reinsurer's Maximum Limits
<u>Workers' Compensation XOL:</u>			
1 st Excess of Loss	American Reinsurance Company (62.5%) GE Reinsurance Corporation (37.5%)	\$1 million	\$1 million
2 nd Excess of Loss	GE Reinsurance Corporation (45%) Aspen Insurance UK Ltd (30%)	\$2 million	\$3 million *
3 rd Excess of Loss	GE Reinsurance Corporation (40%) Aspen Insurance UK Ltd (30%) Hanover Ruckversicherungs-Aktiengesellschaft (30%)	\$5 million	\$5 million
<u>Workers' Compensation Catastrophe XOL:</u>			
1 st Excess of Loss	Hanover Ruckversicherungs-Aktiengesellschaft (30%) Various Reinsurers (70%)	\$10 million	\$10 million
2 nd Excess of Loss	Swiss Reinsurance America Corporation (50%) Various Reinsurers (50%)	\$20 million	\$30 million
3 rd Excess of Loss	Swiss Reinsurance America Corporation (50%) Various Reinsurers (50%)	\$50 million	\$50 million

Type of Contract	Reinsurer's Name	Company's Retention	Reinsurer's Maximum Limits
<u>Private Passenger Auto Liability:</u>			
Quota Share – California	Infinity Insurance Company	10%	90%
Quota Share – All Other States	Infinity Insurance Company	0%	100%

* The Company retains 25% of \$3 million.

The Company and RICA are parties to reinsurance agreements with non-affiliated reinsurers covering business subject to the pooling arrangement. The Company and RICA have a contractual right of direct recovery. Cessions to these non-affiliated reinsurers occur subsequent to the cession of pooled business.

The quota share reinsurance cessions with Infinity Insurance Company (Infinity) occur prior to the cession of pooled business. In January 2006, the Company discontinued writing automobile business. In March 2006, the Company settled all reinsurance balances due and receivable from Infinity under this agreement.

The total net reinsurance recoverable due to the Company as of December 31, 2004 is \$333.1 million, all of which represents amounts due under the inter-company pooling agreement.

Retroactive Reinsurance (Reported as Aggregate Write-ins for Liabilities)

Effective April 1, 1998, the Company, and its parent, RICA, entered into a retroactive reinsurance agreement with Converium, Ltd. (Converium). Under the terms of the agreement, the Company and RICA ceded 95% of \$60 million in excess of \$390 million of its loss and loss adjustment expense reserves to Converium. The agreement pertains to workers' compensation losses unpaid as of March 31, 1998, for insured events with occurrence dates from January 1, 1988 through March 31, 1998. The total consideration paid by the Company and RICA for the agreement was \$14.7 million.

Pursuant to the Statement of Statutory Accounting Principles (SSAP) No. 62, the Company's 2004 Annual Statement disclosed the following effect of the retroactive reinsurance on the Company's balance sheet and income statement:

1. The total amount of retroactive reinsurance was \$57 million. This amount was 100% collateralized by letters of credit. The Company's portion of the retroactive reinsurance was \$1.7 million (3%) and is reflected as a contra-liability in the aggregate write-ins for liability account.
2. The Company's surplus gain of \$1.3 million was restricted as a special surplus funds as an aggregate write-in for special surplus funds.

Stop Loss Agreement

In 1988, RICA entered into a reinsurance contract with Great American Insurance Company (GAIC), an affiliate, which provides for aggregate excess of loss coverage on workers' compensation policies for accident years 1980 through 1987. The contract provides for a maximum coverage of \$35.1 million in excess of \$440.3 million for losses paid on accident years 1980 through 1987. In addition, GAIC agreed to reimburse the RICA for its loss adjustment expenses, at a rate of 14% of losses paid, but not exceeding \$4.9 million. The premium paid by RICA for this coverage was \$16 million. In September 2004, this agreement was commuted and RICA recovered \$3.68 million. Due to the inter-company pooling agreement, the Company recovered \$120,000.

FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2004

Underwriting and Investment Exhibit for the Year Ended December 31, 2004

Reconciliation of Surplus as Regards Policyholders
from December 31, 2001 through December 31, 2004

Statement of Financial Condition
as of December 31, 2004

<u>Assets</u>	<u>Ledger and Nonledger Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>	<u>Notes</u>
Bonds	\$ 19,939,915	\$	\$ 19,939,915	
Cash and short-term investments	2,515,037		2,515,037	
Investments income due and accrued	347,119		347,119	
Premiums and considerations:				
Uncollected premiums and agents' balances course of collection	452,452	27,902	424,550	
Deferred premiums, agents' balances and installments booked but deferred and not yet due	7,102,295		7,102,295	
Accrued retrospective premiums	116	12	104	
Reinsurance:				
Amounts recoverable from reinsurers	2,505,185		2,505,185	
Other amounts receivable under reinsurance contracts	731,218		731,218	
Net deferred tax asset	1,521,809	900,450	621,359	
Guaranty funds receivable or on deposit	29,575		29,575	
Receivable from parent, subsidiaries and affiliates	1,480,933		1,480,933	
Aggregate write-ins for other than invested assets	<u>1,228,918</u>	<u></u>	<u>1,228,918</u>	
Total assets	<u>\$ 37,854,572</u>	<u>\$ 928,364</u>	<u>\$ 36,926,208</u>	
<u>Liabilities, Surplus and Other Funds</u>				
Losses			\$ 15,276,275	(1)
Loss adjustment expenses			1,233,069	(1)
Commission payable, contingent commissions and other similar charges			100,934	
Other expenses			335,876	
Taxes, licenses and fees			57,575	
Current federal and foreign income taxes			43,323	
Unearned premiums			892,530	
Ceded reinsurance premiums payable			3,681,105	
Amounts withheld or retained by company for account of others			315,141	
Drafts Outstanding			1,109,125	
Aggregate write-ins for liabilities			<u>(816,160)</u>	(2)
Total liabilities			22,228,793	
Aggregate write-ins for special surplus funds		\$ 1,268,250		
Common capital stock		3,525,000		
Gross paid-in and contributed surplus		6,395,000		
Unassigned funds (surplus)		<u>3,509,165</u>		
Surplus as regards policyholders			<u>14,697,415</u>	
Total liabilities, surplus and other funds			<u>\$ 36,926,208</u>	

Underwriting and Investment Exhibit
for the Year Ended December 31, 2004

Statement of Income

Underwriting Income

Premiums earned		\$ 10,156,018
Deductions:		
Losses incurred	\$ 5,894,416	
Loss expenses incurred	933,594	
Other underwriting expenses incurred	<u>2,040,002</u>	
Total underwriting deductions		<u>8,868,012</u>
Net underwriting gain		1,288,006

Investment Income

Net investment income earned	\$ 948,970	
Net realized capital losses	<u>(248,193)</u>	
Net investment gain		700,777

Other Income

Net loss from agents' balances charged off	\$ (13,308)	
Finance and service charges not included in premiums	4,247	
Aggregate write-ins for miscellaneous income	<u>(105,824)</u>	
Total other income		<u>(114,885)</u>
Net income before dividends to policyholders and before federal income taxes		1,873,898
Dividends to policyholders		31,936
Federal income taxes incurred		<u>924,043</u>
Net income		<u>\$ 917,919</u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2003		\$ 14,255,079
Net income	\$ 917,919	
Change in net unrealized capital gain (loss)	70,892	
Change in net deferred income tax	283,638	
Change in non-admitted assets	(136,113)	
Aggregate write-ins for gains in surplus (change in excess of statutory reserves over statement reserves)	<u>(694,000)</u>	
Change in surplus as regards policyholders for the year		<u>442,336</u>
Surplus as regards policyholders, December 31, 2004		<u>\$ 14,697,415</u>

Reconciliation of Surplus as Regards Policyholders
from December 31, 2001 through December 31, 2004

Surplus as regards policyholders, December 31, 2001, per Examination			\$ 9,313,728
	<u>Gain in Surplus</u>	<u>Loss in Surplus</u>	
Net income	\$ 2,710,493	\$	
Net unrealized capital losses		101,774	
Change in net unrealized foreign exchange capital gains	101,774		
Change in net deferred income tax	318,284		
Change in non-admitted assets		148,090	
Surplus adjustments: Paid-in	3,200,000		
Aggregate write-ins for gains in surplus (change in excess of statutory reserves over statement reserves)	<u> </u>	<u>697,000</u>	
Totals	<u>\$ 6,330,551</u>	<u>\$ 946,864</u>	
Net increase in surplus as regards policyholders			<u>5,383,687</u>
Surplus as regards policyholders, December 31, 2004, per Examination			<u>\$ 14,697,415</u>

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Losses and Loss Adjustment Expenses

Based on an analysis by a Casualty Actuary for the California Department of Insurance, the Company's loss and loss adjustment expense reserves as of December 31, 2004 and September 30, 2005 were found to be reasonably stated and have been accepted for purposes of this examination.

(2) Aggregate Write-ins for Liabilities

As noted in the reinsurance section of this report, the above captioned liability account includes a \$1.7 million contra-liability related to the retroactive reinsurance with Converium, Ltd. (Converium). Also included in this liability account is an excess of statutory reserve of \$697,000 as required by California Insurance Code (CIC) Section 11558. CIC Section 11558 states, in part, that the minimum reserve required for the workers' compensation line of business must be 65% of earned premiums (loss ratio) for each of the last three-accident years. As of year-end 2004, the Company reported a 61.2% loss ratio for the 2004 accident year for this line of business. The \$697,000 established by the Company represented the difference between the 61.2% loss ratio reported by the Company and the 65% minimum loss ratio required by the Code, after applying the 3% inter-company pooling percentage.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Management and Control - Workers' Compensation Handling Agreement and Workflow Process (Page 4): This agreement was entered into without prior approval from the CA-DOI. It is recommended that the Company obtain approval of this agreement.

Previous Report of Examination

Reinsurance–Inter-company Pooling Agreement (Page 6): It was recommended that management comply with the settlement provisions of the inter-company pooling agreement. The Company has complied with the recommendation.

Accounts and Records (Page 9): It was recommended that management complete the development and testing of its business continuity plan. The Company has complied with the recommendation.

ACKNOWLEDGEMENT

The courtesy and cooperation extended by the Company's officers and employees during the course of this examination are hereby acknowledged.

Respectfully submitted,

Duane Armstrong, CFE
Examiner-In-Charge
Senior Insurance Examiner (Supervisor)
Department of Insurance
State of California